2001

Charles E. Freegard v. First Western National Bank : Brief of Appellant

Utah Supreme Court

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IN THE SUPREME COURT

OF THE STATE OF UTAH

CHARLES E. FREEGARD,

Plaintiff-Appellant,

vs.

FIRST WESTERN NATIONAL BANK, a corporation,

Defendant-Respondent.

Case Nos. 19503 19794

BRIEF OF APPELLANT

CONSOLIDATED APPEALS FROM JUDGMENTS OF THE SEVENTH JUDICIAL DISTRICT COURT OF GRAND COUNTY THE HONORABLE BOYD BUNNELL, PRESIDING

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BRIEF OF APPELLANT

STATEMENT OF THE NATURE OF THE CASE

These cases are consolidated on appeal and involve claims by appellant Freegard that respondent, First Western National Bank, as an escrow agent, wrongfully endorsed over fire insurance proceeds belonging to appellant.

DISPOSITION IN LOWER COURT

In the first case (District Court Civil No. 4939), the District Court granted respondent's Motion for Judgment on the Pleadings on the basis that disposition of insurance proceeds was not within the scope of the bank's fiduciary duty under the escrow agreement and that appellant had failed adequately to allege negligence. Appellant took an appeal to this court from that decision and judgment. (Supreme Court No. 19503).

Appellant then filed a second suit (District Court Civil No. 5052) grounded in negligence, and the District Court dismissed

that case on Motion of respondent based on a claim res judicata and that respondent owed appellant no duty of due care. Appellant has also appealed from that decision and judgment (Supreme Court No. 19794).

RELIEF SOUGHT ON APPEAL

Appellant seeks a reversal of the Judgments of the District Court in both cases, a finding that appellant has stated claims for negligence and breach of contractual duty and a remand with instructions to grant appellant a trial.

STATEMENT OF FACTS

On September 13, 1978, appellant, as Seller, entered into a Uniform Real Estate Contract with Janice Campbell and David Clark, as Buyers, for the sale of a certain parcel of real property, including a house, in Grand County, State of Utah. (No. 19503, R. 4-5)

The contract provided in part that the Buyers were to keep the premises insured in an amount not less than the unpaid balance owing on the contract.

In connection with the sale, appellant, the Buyers and respondent, First Western National Bank (hereinafter referred to as the "Bank") executed an escrow agreement (No. 19503, R. 20-21) whereby the Bank would collect the payments under the Uniform Real Estate Contract and credit them to appellant's account.

On January 9, 1981, the house located on the subject property was destroyed by fire.

Because the respondent First Western National Bank was erroneously listed as a loss payee instead of Appellant, the insurer paid the fire insurance proceeds to Clark and the Bank. The Bank endorsed the draft over to Clark, who used the funds to purchase two mobile homes, the titles to which he deposited in escrow with the Bank as substitute security for the Uniform Real Estate Contract.

Appellant then filed the first suit, District Court Civil No. 4939, to recover the insurance proceeds. In a Complaint and Amended Complaint (19503, R. 1-10), Appellant based his claim against the Bank on a breach of fiduciary duty arising from the escrow agreement and, specifically, a clause contained in the agreement making the Bank liable for any damages caused by its "negligence or willful misconduct."

The Bank answered and filed a Motion for Judgment on the pleadings and a Memorandum in Support (19503, R. 22-25), claiming that the Bank, based on the allegations of Appellant's pleadings, was entitled to judgment as a matter of law.

The Court granted the Bank's Motion and rendered a judgment against Appellant for no cause of action. (19503, R. 30-33),

Appellant filed an appeal from the Court's decision and judgment (19503, R. 34-35) and also filed a second action against the Bank grounded in negligence. (District Court Civil No. 5052)

The Bank next filed a Motion to Dismiss Appellant's second suit, claiming it was barred by the doctrine of res judicata and on the theory that the Bank owed no duty of care to

ward appellant with reference to the insurance proceeds. (No. 19794, R. 10-19)

Appellant filed a Memorandum in Opposition to the Bank's Motion (No. 19794, R. 20-27) and the Court granted the Bank's Motion, dismissing appellant's Complaint with prejudice. (No. 19794, R. 32038)

Appellant then filed an Appeal from the Court's judgment in the second case and on Motion of Appellant and Stipulation of Counsel, both cases have been consolidated on appeal.

ARGUMENT

POINT I

THE DISTRICT COURT ERRED IN RULING THAT RESPONDENT OWED NO CONTRACTURAL DUTY TO PLAINTIFF CONCERNING DISPOSITION OF THE INSURANCE PROCEEDS

In the first case, the District judge found that the Bank owed no contractural duty to appellant with reference to the fire insurance proceeds because the escrow agreement was silent on that point.

Appellant contends that the District Court defined too narrowly the scope of the fiduciary duty owed by an escrow agent to its principals.

It is a well established rule, conceded by the Bank in its supporting Memorandum in the first case, that an escrow agreement makes the depositary the agent of both the Buyer and Seller in a real estate transaction. Morris v. Clark, 100 Utah 252, 112 P.2d 153 (1941)

The Bank's position, adopted by the District Court, postulated that the Bank was not liable for wrongfully endorsing over the insurance proceeds to Clark because the escrow agreement was silent as to disposition of insurance proceeds and, thus, the Bank owed no duty ot Appellant concerning the same.

The Bank's theory is flawed in two respects. First, the escrow agreement itself clearly provides for liability for loss or damage caused either by the negligence or willful misconduct of the Bank. That language does not limit its application only to the handling of matters which are specifically set forth in the escrow instructions. Second, an escrow depository is a fiduciary held to a higher standard of care in dealing with its principals, and is obligated not to exceed the authority vested in it by the escrow agreement. The depository will be held liable for any damages caused by exceeding such authority.

In support of the first above-mentioned point, the escrow agreement provides as follows: "All funds collected on this escrow are to be distributed as follows," and further sets forth to whom the funds are to be paid. When the bank received and accepted the insurance check, the Bank had an obligation to treat the check as collected funds and disbursed it according to the escrow agreement.

The fact that the insurance check did not specifically state "payment on contract" does not alter the fact that the insurance proceeds were funds to be used to apply to the balance

due the respondents as provided in the sales contract between the buyer and Respondent.

The Bank became involved as a party to the insurance transaction because it was named a loss payee and was the escrow agent. Otherwise it would have been a stranger to insurance transaction. The actions of the Bank in accepting and endorsing the check to the Buyer were obviously pursuant to the duty the Bank considered itself to have pursuant to the escrow agreement.

The case of National Bank of Washington v. Equity Investors, 81 Wash. 2d 886, 506 P.2d 20 (1973), which was relied upon by the Bank in its Memorandum to the District Court, actually supports Appellant's position on the second point mentioned above. The Court therein stated:

> Thus, it is the rule that an escrow agent or holder becomes liable to his principals for damage proximately resulting from his breach of the instructions, or from his exceeding the authority conferred on him by the instructions. (Emphasis added) 506 P.2d at 35

The fiduciary nature of the escrow relationship obligates the depositary to act in strict compliance with its duties under the agreement. It constitutes a breach of the fiduciary duty to deviate from the terms of the agreement and the escrow agent is liable for all damages proximately resulting from such deviation. Tucson Title Insurance Co. v. D'Ascoli, 94 Ariz. 230, 383 P.2d 984 (1962); Miller v. Craig, 27 Ariz. App. 789, 558 P.2d 984 (1976).

The Supreme Court of Utah has adopted the position that an escrow agent which exceeds the authority of its escrow instructions is liable for damages caused to a principal. In W. P. Harlin Construction Co. v. Continental Bank & Trust Co., 23 Utah 2d 422, 464 P.2d 585 (1970), the Utah Supreme Court affirmed a judgment against an escrow agent who exceeded his authority by paying a claim other than the one for which the check in question had been delivered.

Consequently, Appellant asserts that the Bank in this case owed a contractual, fiduciary duty to Appellant when it undertook to exceed its escrow authority by disbursing the fire insurance proceeds to one of the Buyers. Such a disbursement without checking to see who was the proper party to receive the proceeds constituted a breach of that fiduciary duty.

As a result, the District Court erred in granting a judgment of no cause of action against Appellant in the first case.

POINT II

THE DISTRICT COURT ERRED IN FINDING THAT NO DUTY OF DUE CARE EXISTED SEPARATE FROM ANY CONTRACTUAL DUTY.

In addition to finding that no contractual duty with reference to insurance proceeds arose from the terms of the escrow agreement itself, the district judge, in both the first and second written decisions, found that the Bank had not been negligent in handling the insurance proceeds on a theory that a duty of due

care would arise only if there were an express agreement in the escrow instructions concerning insurance proceeds.

In the first written decision, the Court stated:

> Without some allegation of duty owed under the express agreement, there is no allegation of negligence properly stated. (No. 19503, R. 31)

That position was mimicked in the District Court's written decision in the second case wherein the Court stated:

> There is no mention of the existence of any insurance or payment to be made in case of any loss and, therefore, no duty was created with regard to insurance proceeds to which a standard of conduct could attach. (No. 19794, R. 34)

The District Court's position on this issue fundamentally miscomprehends the law regarding negligence. The duty of exercising due care in a given situation does not depend for its existence on a co-extensive contractual right or obligation.

The logic of the Court's position is such that a party injured by the negligence of an automobile driver could not recover for his injuries unless a contractual right or obligation existed. In fact, it is Hornbook law that the duty to exercise due care derives from the operation of the automobile itself and does not depend on any such contractual relationship between one driver and another.

In the present case, assuming for the purpose of argument that no contractual duty existed, the duty of the Bank to exercise ordinary care arose from its undertaking to disburse the insurance

proceeds whether or not the escrow instructions covered such a matter. The failure of the Bank to ascertain, or even attempt to ascertain, the proper recipient of the funds amounts to a breach of the duty to exercise due care once having undertaken the task. The Oregon appellate court in the case of McDonald v. Title Insurance Company of Oregon, 49 Or. App. 1055, 621 P.2d 654 (1981), held that a volunteer is liable for its negligence. In that particular case a title insurer/escrow officer voluntarily chose to advise the insured plaintiffs on a matter outside the title policy or escrow instructions. The plaintiff claimed that, despite an absence of contractual duty, once Defendants chose to give advise separate from the contract, they had a duty of exercising reasonable care in providing such advice. Noting this type of claim involved the "rescue" doctrine, the court accepted the argument and found the title insurance company liable for the insureds' loss.

The Florida courts also find a duty in such circumstances. In Biadi v. Lawyers Title Insurance Co., 374 So. 2d 30 (Fla. App. 1979), the court recognized:

> Although Florida law adheres to the general proposition that the "escrow instructions" define the duties of the escrow agent, there must be consideration as to further steps that were taken in this transaction which concern "additional" or "superseding" duties that could be construed to have been voluntarily undertaken by appellee-escrow agent and about which a jury should decide. Id. at 35.

The court overturned a Summary Judgment Order in the Biadi case and remanded the case to the lower court to determine whether or not the escrow agent acted with care and diligence when it acted voluntarily. A footnote to that instruction indicated the following negligence doctrine applied in that determination:

> There have been decisions in negligence cases where the allegedly negligent act, even though gratuitously undertaken, has been subjected to the standard of duty of due care. See Banfield v. Addington, 104 Fla. 661, 140 So. 893 (1932) and 6 ALR 2d 284. Id. at 35, F. N. 14

A negligence action may exist entirely separate and apart from any contractual relationship which might exist between the parties. DCR Incorporated v. Peak Alarm Co., 663 P.2d 433 (Utah, 1983) Thus, even if this Court finds that the Bank breached no contractual duty to Appellant it may find that the Bank owed a duty of due care by volunteering to disburse the insurance proceeds.

In fact, the Court in DCR Incorporated v. Peak Alarm Co., supra, extends the duty of due care even further when the parties involved also share a contractual relationship for performance of services. The Court stated:

> Similarly, contractual relationships for the performance of services impose on each of the contracting parties a duty of due care towards the other, apart from the specific obligations expressed in the contract itself. The care to be exercised in any particular case depends upon the circumstances of that case and on the extent of foreseeable danger involved and must be determined as a question of fact. 663 P.2d at 435

It is apparent that the District Court totally misconstrued the law relating to negligence and Appellant is entitled to a reversal and remand for trial on this point.

POINT III

THE DISTRICT COURT ERRED IN GRANTING RESPONDENT'S MOTION TO DISMISS UNDER THE DOCTRINE OF RES JUDICATA.

As part of the Court's overall decision in the first suit, the Court found that a claim for negligence was not properly stated by Appellant.

While Appellant felt that the Complaint and the Amended Complaint in the first suit adequately raised an issue of negligence, in response to the above-mentioned portion of the District Court's ruling, Appellant filed the second suit, basing the claim solely on negligence.

Assuming only for purposes of argument that the District Court was correct in finding that negligence was not plead properly in the first case, it was clearly erroneous for the Court to rule that the second suit was barred by the doctrine of res judicata.

It must be noted that the Motion filed by the Bank in the first case was for a judgment on the pleadings. No affidavits or other material beyond the pleading and exhibits attached thereto were filed to save Memoranda which discussed only the matters raised in the pleadings. Consequently, the Court did not and, rightfully, could not, treat the Motion as one for a summary judgment on the merits

Consequently, the District Court's assertion in the ruling in the second suit that it "granted summary judgment against the plaintiff" in the first suit in incorrect. The Court dealt only with matters raised by the pleadings and could not convert that ruling to a summary judgment on the merits as the ruling in the second case purports to do.

Where the Bank and the Court reached only the issue of a contractual duty, it was clearly improper for the District Court to bar the second suit on grounds of res judicata where the second suit was clearly based on a claim of negligence.

Where the issue of negligence was not addressed in the Motion for Judgment on the pleadings, it was improper for the Court to grant the Motion to Dismiss under a theory of res judicata.

The District Court relied in its dismissal of the second suit on the case of Wheadon v. Pearson, 14 Utah 2d 45, 376 P.2d 946 (1962). However, the District Court ignored the language of Pearson, supra, limiting the application of res judicata as a bar:

> On the other hand, where the claim, demand or cause of action is different in the two cases then the former is res judicata of the latter only to the extent that the former actually raised and decided the same points and issues raised in the latter. 376 P.2d at 947

Such is precisely the case before the Court. The District Court in Appellant's first case construed the Complaint and the Amended Complaint as encompassing only a contractual issue and, because the Court did not, and could not, in its first decision,

treat the matter as a Motion for Summary Judgment, then the contractual issue was the only issue decided by judgment on the pleadings.

Consequently, the Court should have denied the Bank's Motion to Dismiss in the second case and allowed the case to proceed to trial. It was only the District Court's fundamental miscomprehension of the doctrine of res judicata and of the distinction between contractual duties and negligence theory that led to the onerous result of Appellant's not being permitted any remedy for the obvious mishandling of the insurance proceeds, which should properly belong to Appellant under the Uniform Real Estate Contract.

CONCLUSION

Based on the foregoing, Appellant requests a reversal of the District Court's decisions and judgments in both cases and a remand for trial on both claims of breach of a contractual duty and negligence.

DATED this 25 day of April, 1984.

Respectfully submitted,

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MAILING CERTIFICATE

I hereby certify that I mailed two true and correct copies of the foregoing Brief of Appellant to Aldine J. Coffman, Jr., 59 East Center Street, P. O. Drawer J, Moab, Utah, 84532-1371, on this _____ day of April, 1984.

_____